Supreme Court, U.S.
FILED

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IN THE

Supreme Court of the United States

PETER THOSTESON,
Petitioner,

v.

UNITED STATES OF AMERICA,
Respondent.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Eleventh Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Petitioner became president of a failing small business and shortly thereafter filed for bankruptcy protection for the business. The former president had stolen payroll withholding taxes and absconded, and his whereabouts are now unknown. Prior to and while the company was under the jurisdiction of the bankruptcy court, Petitioner made partial payments of the back payroll taxes to the Internal Revenue Service and made payments to other creditors with the dwindling resources of the failing company. Instead of pursuing the old president or availing itself of bankruptcy remedies against the company, the Government assessed a payroll tax penalty of over $1 million against the Petitioner personally. The question presented is:

> Whether the payroll tax penalty provision of 26 U.S.C. § 6672, which requires that a responsible person "willfully" fail to pay over withheld taxes to the Government, applies to an employee who has reasonable cause for not remitting such taxes.

TABLE OF CONTENTS

	Page
QUESTION PRESENTED	i
TABLE OF AUTHORITIES	iv
OPINIONS BELOW	1
JURISDICTION	1
STATUTORY PROVISION INVOLVED	1
STATEMENT OF THE CASE	5
REASONS FOR GRANTING THE WRIT	9
I. CERTIORARI IS WARRANTED TO RESOLVE A CONFLICT AMONG THE CIRCUIT COURTS OF APPEAL AS TO WHETHER THE PAYROLL TAX PENALTY OF 26 U.S.C. § 6672, WHICH REQUIRES A WILLFUL FAILURE TO REMIT PAYROLL TAXES, CONTAINS A REASONABLE CAUSE LIMITATION.	9
II. CERTIORARI IS WARRANTED BECAUSE THE ELEVENTH CIRCUIT COURT OF APPEALS HAS DECIDED AN IMPORTANT QUESTION OF FEDERAL LAW REGARDING THE PAYROLL TAX PENALTY THAT HAS NOT BEEN, BUT SHOULD BE, SETTLED BY THIS COURT.	14
CONCLUSION	15

TABLE OF AUTHORITIES

CASES — Page

Beacon Theaters, Inc. v. Westover, 359 U.S. 500 (1959) 11
Bowen v. United States, 836 F.2d 965 (5th Cir. 1988) 12
Burden v. United States, 486 F.2d 302 (10th Cir. 1973), *cert. denied*, 416 U.S. 904 (1974) 9
Dimick v. Schiedt, 293 U.S. 474 (1935) 11
Finley v. United States, 123 F.3d 1342 (10th Cir. 1997) 10, 11, 13
Fowler v. United States, 820 F. Supp. 1390 (D. Wyo. 1993) 10
Harrington v. United States, 504 F.2d 1306 (1st Cir. 1974) 12
Logal v. United States, 195 F.3d 229 (5th Cir. 1999) 12
Mazo v. United States, 591 F.2d 1151 (5th Cir. 1979) 9
Monday v. United States, 421 F.2d 1210 (7th Cir.), *cert. denied*, 400 U.S. 821 (1970) 12
Pacific National Insurance Co. v. United States, 422 F.2d 26 (9th Cir.), *cert. denied*, 398 U.S. 937 (1970) 12
Ratzlaf v. United States, 510 U.S. 135 (1994) 14
Smith v. United States, 894 F.2d 1549 (11th Cir. 1990) 12
Thibodeau v. United States, 828 F.2d 1499 (11th Cir.1987) 12, 13
Thosteson v. United States, 182 F. Supp. 2d 1189 (M.D. Ala. 2001) 1
Thosteson v. United States, 331 F.3d 1294 (11th Cir. 2003) 1, 8, 11, 12
Turpin v. United States, 970 F. 2d 1344 (4th Cir. 1992) 13

TABLE OF AUTHORITIES—Continued

Page

Williams v. United States, 931 F.2d 805 (11th Cir. 1991) 10, 12
Winter v. United States, 196 F.3d 339 (2nd Cir. 1999) 12

STATUTES

26 U.S.C. § 6672 ..... *passim*
28 U.S.C. § 1254(1) 1
Fed. R. Civ. P. Rule 50 ..... 8, 10

OTHER AUTHORITIES

BLACK'S LAW DICTIONARY (5th ed. 1979) ... 13
Corrie Lynn Lyle, Note: *The Wrath of I.R.C. § 6672; The Renewed Call for Change—Is Anyone Listening? If You Are a Corporate Official, You Had Better Be*, 74 S. Cal. L. Rev. 1133 (May 2001) 10, 14, 15

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Eleventh Circuit is reported at *Thosteson v. United States*, 331 F.3d 1294 (11th Cir. 2003), and is reproduced in the Appendix to this Petition ("Pet. App.") at 1a-12a. The Court of Appeals' order denying rehearing is unpublished, but is reproduced at Pet. App. 24a. The opinion of the United States District Court for the Middle District of Alabama is reported at 182 F. Supp. 2d 1189 (M.D. Ala. 2001), and is reproduced at Pet. App. 13a-20a. The order of the District Court modifying its opinion is not reported, but is reproduced at Pet. App. 21a-23a.

JURISDICTION

The opinion of the United States Court of Appeals for the Eleventh Circuit was entered on June 2, 2003. The Court of Appeals denied a timely petition for rehearing on July 9, 2003. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTORY PROVISION INVOLVED

Section 6672 of title 26, United States Code.

Section 6672. Failure to Collect and Pay Over Tax, or Attempt to Evade or Defeat Tax.

(a) Any person required to collect, truthfully account for, and pay over any tax imposed by this title who *willfully* fails to collect such tax, or truthfully account for and pay over such tax or the payment thereof, shall, in addition to other penalties provided by law, be liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over. No penalty shall be imposed under section 6653 of part II of subchapter A of chapter 68 for any offense to which this section is applicable.

(b) Preliminary notice requirement.—

(1) In general.—No penalty shall be imposed under subsection (a) unless the Secretary notifies the taxpayer in writing by mail to an address as determined under section 6212(b) or in person that the taxpayer shall be subject to an assessment of such penalty.

(2) Timing of notice.—The mailing of the notice described in paragraph (1) (or, in the case of such a notice delivered in person, such delivery) shall precede any notice and demand of any penalty under subsection (a) by at least 60 days.

(3) Statute of limitations.—If a notice described in paragraph (1) with respect to any penalty is mailed or delivered in person before the expiration of the period provided by section 6501 for the assessment of such penalty (determined without regard to this paragraph), the period provided by such section for the assessment of such penalty shall not expire before the later of—

(A) the date 90 days after the date on which such notice was mailed or delivered in person, or

(B) if there is a timely protest of the proposed assessment, the date 30 days after the Secretary makes a final administrative determination with respect to such protest.

(4) Exception for jeopardy.—This subsection shall not apply if the Secretary finds that the collection of the penalty is in jeopardy.

(c) Extension of period of collection where bond is filed.—

(1) In general.—If, within 30 days after the day on which notice and demand of any penalty under subsection (a) is made against any person, such person—

(A) pays an amount which is not less than the minimum amount required to commence a proceeding in court with respect to his liability for such penalty,

(B) files a claim for refund of the amount so paid, and

(C) furnishes a bond which meets the requirements of paragraph (3), no levy or proceeding in court for the collection of the remainder of such penalty shall be made, begun, or prosecuted until a final resolution of a proceeding begun as provided in paragraph (2). Notwithstanding the provisions of section 7421(a), the beginning of such proceeding or levy during the time such prohibition is in force may be enjoined by a proceeding in the proper court. Nothing in this paragraph shall be construed to prohibit any counterclaim for the remainder of such penalty in a proceeding begun as provided in paragraph (2).

(2) Suit must be brought to determine liability for penalty.—If, within 30 days after the day on which his claim for refund with respect to any penalty under subsection (a) is denied, the person described in paragraph (1) fails to begin a proceeding in the appropriate United States district court (or in the Court of Claims) for the determination of his liability for such penalty, paragraph (1) shall cease to apply with respect to such penalty, effective on the day following the close of the 30-day period referred to in this paragraph.

(3) Bond.—The bond referred to in paragraph (1) shall be in such form and with such sureties as the Secretary may by regulations prescribe and shall be in an amount equal to 1 1/2 times the amount of excess of the penalty assessed over the payment described in paragraph (1).

(4) Suspension of running of period of limitations on collection.—The running of the period of limitations provided in section 6502 on the collection by levy or by

a proceeding in court in respect of any penalty described in paragraph (1) shall be suspended for the period during which the Secretary is prohibited from collecting by levy or a proceeding in court.

(5) Jeopardy collection.—If the Secretary makes a finding that the collection of the penalty is in jeopardy, nothing in this subsection shall prevent the immediate collection of such penalty.

(d) Right of contribution where more than 1 person liable for penalty.—If more than 1 person is liable for the penalty under subsection (a) with respect to any tax, each person who paid such penalty shall be entitled to recover from other persons who are liable for such penalty an amount equal to the excess of the amount paid by such person over such person's proportionate share of the penalty. Any claim for such a recovery may be made only in a proceeding which is separate from, and is not joined or consolidated with—

(1) an action for collection of such penalty brought by the United States, or

(2) a proceeding in which the United States files a counterclaim or third-party complaint for the collection of such penalty.

(e) Exception for voluntary board members of tax-exempt organizations.—No penalty shall be imposed by subsection (a) on any unpaid, volunteer member of any board of trustees or directors of an organization exempt from tax under subtitle A if such member—

(1) is solely serving in an honorary capacity,

(2) does not participate in the day-to-day or financial operations of the organization, and

(3) does not have actual knowledge of the failure on which such penalty is imposed.

The preceding sentence shall not apply if it results in no person being liable for the penalty imposed by subsection (a).

(Emphasis added.)

STATEMENT OF THE CASE

This is an action for refund of a payroll tax penalty assessed against an individual officer, Petitioner Peter Thosteson, of a corporation, Lorac, Inc. ("Lorac"). Lorac was an employee leasing company. It conducted business by entering into contracts with companies—clients—whereby Lorac would hire all of the client's employees and then lease the employees back to the client. Lorac would provide payroll, insurance, and human resource services to the clients. Lorac's duties included processing of payroll, Federal Unemployment Tax Act ("FUTA") contributions, federal income tax withholdings, and payroll tax returns (Forms 940 and 941). Clients would transfer funds to Lorac, and Lorac would remit the taxes to the Government.

From the date of its formation in 1993 until November 1995 Garner Umphrey was the sole or controlling shareholder of Lorac. Peter Thosteson, Petitioner, was initially Lorac's vice-president in charge of marketing, with his main responsibility being sales. Petitioner had limited authority to hire and fire employees, to set salaries and wages, to determine financial policy, to pay employees, and to enter into loan agreements. Petitioner's limited authority was subject to the ultimate approval of Umphrey.[1] Any checks written for accounts payable were subject to the approval of Umphrey.

During the spring of 1995, Petitioner paid Umphrey $288 for a 24% stake in Lorac, but Umphrey never cashed the

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[1] This is borne out by the testimony of Cynthia Sauls Bolton, the supervisor of the payroll department, who testified that she was instructed that all direction was to come from Garner Umphrey and that she was to ignore any instructions coming from Petitioner.

check and Lorac never issued a stock certificate to Petitioner. Until November 1995, Umphrey was either the sole shareholder or controlling shareholder and, as such, exercised ultimate control over Lorac.

Petitioner did, during the time period at issue, sign two Form 941s (payroll tax returns) on behalf of Lorac. The first was for the third calendar quarter of 1995, and was signed at the behest of an agent of the Internal Revenue Service ("IRS"). The second was for the fourth calendar quarter of 1995, and was signed only after Lorac had filed for bankruptcy protection. These quarters are the last two quarters of the six consecutive quarters of payroll taxes at issue.

On August 28, 1995, Petitioner discovered that Umphrey had not been remitting Lorac's payroll taxes to the Government. Petitioner confronted a confidant of Umphrey who admitted that Lorac had failed to remit payroll taxes during the final two quarters of 1994 through August 1995.

Petitioner then confronted Umphrey about the unpaid taxes, but the discussions were unproductive, and Petitioner could not ascertain the amount of the tax liability. In spite of Umphrey's authority, Petitioner requested that the bookkeeping department immediately begin paying $30,000 per week to the IRS towards the liability. Soon, after only a few payments to the IRS had been made, Umphrey learned of the payments and ordered the bookkeeping department to cease making them. Umphrey thwarted the Petitioner's efforts to see that the payroll taxes were remitted to the Government.

In November 1995, during the last payroll tax quarter at issue, and just prior to Lorac's filing for bankruptcy, Umphrey appointed the Petitioner as acting President of Lorac as the company was failing and headed toward bankruptcy. This was apparently done in hopes that Petitioner might be able to bail Lorac out of its financial problems.

Shortly thereafter, Petitioner Thosteson had Lorac file for protection with the United States Bankruptcy Court. After the bankruptcy filing, Umphrey disappeared. It was subsequently discovered that Umphrey had stolen some of the withheld payroll taxes and absconded. Although the Government sued Umphrey in absentia for the withheld payroll taxes, his whereabouts remain unknown.

Peter Thosteson, Petitioner, did not steal and did not run. He voluntarily remained as president of Lorac and submitted Lorac to the jurisdiction of the United States Bankruptcy Court.

On December 29, 1995, the bankruptcy court entered an order enjoining the IRS from contact with Lorac's clients. As a part of the order, Lorac, with Petitioner as president, began paying $10,000 weekly to the IRS in an attempt to satisfy the back payroll taxes. In a subsequent proceeding, the bankruptcy court entered an order setting aside the injunction on or about August 6, 1996. On the advice of counsel, Petitioner Thosteson converted Lorac to Chapter 7 bankruptcy status, the company ceased doing business, and the payments to the IRS stopped. Prior to and during the bankruptcy, Petitioner Thosteson divided the dwindling and inadequate resources of the bankrupt company among various creditors and others. Thosteson paid employees, utilities, and made one small payment to a joint venture that he and his wife had with Lorac, most of which payments were subject to the bankruptcy court's imposition of a payment plan for Lorac's creditors.

Instead of seeking the readily available bankruptcy remedies against Lorac and instead of pursuing Umphrey, the Government assessed a payroll tax penalty of over $1 million against Petitioner Thosteson personally. On July 11, 1997, pursuant to section 6672 of the Internal Revenue Code of 1986, as amended (the "Code"), a delegate of the Secretary of the Treasury (the "Secretary") made an assessment against the Petitioner for the "trust fund" portion of the payroll taxes (*i.e.*, the Form 941 taxes), said taxes being attributable to the final two calendar quarters of 1994 and all four

quarters of 1995. The amount of the penalty sought by the Secretary was $1,293,427.09.

The Petitioner filed an action against the United States seeking a refund of his partial payment of the tax penalty assessment. A jury trial was held in the United States District Court for the Middle District of Alabama, and the jury returned a verdict in Petitioner's favor for all of the quarters at issue. The jury found that Thosteson was not a responsible party for the last two quarters of 1994 and the first two quarters of 1995 (*i.e.*, before he discovered that Umphrey had not paid the payroll taxes to the Government) and found that Thosteson's lack of payment for the last two quarters of 1995 was not willful.

Pursuant to Rule 50 of the Federal Rules of Civil Procedure, the district court granted judgment as a matter of law for the Defendant United States of America, holding that the two elements required by section 6672 (*i.e.*, "willful" conduct and "responsible person" status) had been met by the Petitioner for all six calendar quarters at issue. In making this decision, the district court failed to address the issue of whether the phrase "willful" as used in the statute was limited by "reasonable cause."

The Petitioner appealed to the Eleventh Circuit Court of Appeals, which affirmed the district court's order and subsequently denied a petition for rehearing en banc. Among other things, the Court of Appeals held that Thosteson's payment of creditors other than the IRS, after having knowledge of the payroll tax delinquency, rendered him retroactively liable for all previously unpaid payroll taxes. The Court of Appeals noted that whether or not a defense of "reasonable cause" can avoid a finding of willfulness had not been addressed by the Eleventh Circuit, and rejected Petitioner's argument to apply that defense in this case. *Thosteson v. United States*, 331 F.3d 1294, 1301 (11th Cir. 2003).

REASONS FOR GRANTING THE WRIT

I. CERTIORARI IS WARRANTED TO RESOLVE A CONFLICT AMONG THE CIRCUIT COURTS OF APPEAL AS TO WHETHER THE PAYROLL TAX PENALTY OF 26 U.S.C. § 6672, WHICH REQUIRES A WILLFUL FAILURE TO REMIT PAYROLL TAXES, CONTAINS A REASONABLE CAUSE LIMITATION.

Section 6672 imposes a 100% payroll tax penalty on a responsible person who willfully fails to remit withheld payroll taxes on behalf of his employer to the Government. The courts have substantially lowered the threshold for imposing this often crushing penalty on individuals, even where an individual is not culpable under the plain meaning of the term "willful."

In the context of section 6672, the courts have held that no bad motive or evil intent is required. *Burden v. United States*, 486 F.2d 302, 304 (10th Cir. 1973), *cert. denied*, 416 U.S. 904 (1974). Rather, "willfulness" in the context of section 6672, has been interpreted to mean merely a "voluntary, conscious and intentional act." *Mazo v. United States*, 591 F.2d 1151, 1155 (5th Cir. 1979). A responsible person acts willfully if he simply acts with knowledge of non-payment or shows a "reckless disregard of a known or obvious risk that trust funds may not be remitted to the government such as by failing to investigate or to correct mismanagement after being notified that withholding taxes have not been duly remitted." *Id.* at 1154 (citation omitted).

Moreover, many courts, including the Eleventh Circuit Court of Appeals, have determined that certain factual paradigms establish willfulness as a matter of law even when the facts do not involve personal fault or an intentional failure to remit withholding taxes to the United States. One of these paradigms is the payment of other bills, no matter how

insignificant, with any knowledge that payroll taxes have not been paid at any time in the past. *See Williams v. United States*, 931 F.2d 805 (11th Cir. 1991). "These paradigms obviously create an expansive web of liability 'as a matter of law' and significantly ease the government's burden under Fed. R. Civ. P. 50(b)." *Finley v. United States*, 123 F.3d 1342 (10th Cir. 1997). This "strict liability" approach to the willful element of section 6672 has not gone unnoticed, or uncriticized, by the commentators or the courts.[2]

In 1997, in response to this draconian power of the Internal Revenue Service ("IRS"), and in sharp contrast to the Eleventh Circuit Court of Appeals, the Tenth Circuit Court of Appeals expressly adopted and defined a reasonable cause limitation to liability under section 6672 in *Finley*, 123 F.3d 1342. In doing so, the Tenth Circuit stated that it was:

> troubled by the possibility [that] courts have transformed 26 U.S.C. § 6672 into a *strict liability statute*, outside the jury's realm, by (1) broadly defining the most likely fact scenarios leading to a failure to pay withholding taxes as "willful" conduct as a matter of law, and (2) closing the door on any opportunity for a responsible person to distinguish his case from those factual scenarios, or paradigms (*i.e.*, demonstrate reasonable cause for failure to pay). As "'[m]aintenance of the jury as a fact finding body is of such importance and occupies so firm a place in our history and jurisprudence, it is our duty to

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[2] *See* Corrie Lynn Lyle, *Note: The Wrath of I.R.C. § 6672; The Renewed Call for Change—Is Anyone Listening? If You Are a Corporate Official, You Had Better Be*, 74 S. Cal. L. Rev. 1133 (May 2001) (stating that the reorganization of Section 6672 from the other criminal provisions of the Code in 1954 has caused the term willful to have lost its original meaning, and that some courts almost interpret it as a strict liability provision, and calling for more judicial scrutiny in interpreting the statute). *Fowler v. United States*, 820 F. Supp. 1390, 1395 n.2 (D. Wyo. 1993) ("Section 6672 is not a strict liability statute, although after reviewing the case law, one might believe otherwise.").

> carefully scrutinize any apparent curtailment of that function.'" *Beacon Theaters, Inc. v. Westover*, 359 U.S. 500, 501 (1959) (quoting *Dimick v. Schiedt*, 293 U.S. 474, 486 (1935)).

Finley, 123 F.3d at 1346-47 (emphasis addedd).

The Tenth Circuit, in an effort to both protect the Government's revenue and to preserve a role for the jury without undermining existing precedent, expressly recognized a "reasonable cause" limitation on the use of factual paradigms to define willfulness. *Finley*, 123 F.3d at 1348. In this way, the courts could continue to maintain pressure on responsible persons to pay taxes, but at the same time provide those responsible persons with a way to demonstrate that there was reasonable cause for the failure to pay. *Id.* The court delineated the circumstances when the reasonable cause limitation would apply as: (1) where the taxpayer has made reasonable efforts to protect the trust funds, and (2) those efforts have been frustrated by circumstances outside the taxpayer's control. *Id.* The court felt that this approach would preserve the role of the jury to determine based on all relevant evidence whether a taxpayer's conduct was motivated by the "requisite scienter." *Id.*

The Eleventh Circuit has refused to adopt the reasonable cause limitation on the broad definition of willfulness.[3] Instead, as in this case, the Eleventh Circuit has continued to seize upon certain factual paradigms to define willfulness as a matter of law. For instance, "the willfulness requirement . . . is satisfied if the responsible person has knowledge of payments to other creditors after he becomes aware of the failure to remit the withheld taxes." *Thosteson v. United*

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[3] "This Circuit has not yet addressed whether a defense of 'reasonable cause' can avoid a finding of willfulness in this context. We decline, however, to address this issue today." *Thosteson v. United States*, 331 F.3d 1294, 1301 (11th Cir. 2003).

States, 331 F.3d 1294, 1300 (2003) (citing *Williams*, 931 F.2d at 810; *Smith v. United States*, 894 F.2d 1549, 1553 (11th Cir. 1990); and *Thibodeau v. United States*, 828 F.2d 1499, 1505 (11th Cir.1987)).

The Fifth Circuit Court of Appeals has recognized conceptually that the concept of reasonable cause might exist, but has apparently never found a set of facts where it deemed that an individual had shown a reasonable cause. *See Logal v. United States*, 195 F.3d 229 (5th Cir. 1999) ("In *Bowen v. United States*., 836 F.2d 965, 968 (5th Cir. 1988), we stated that 'although we have recognized conceptually that a reasonable cause may militate against a finding of willfulness, no taxpayer has yet carried that pail up the hill.'").

The First, Ninth, and Seventh Circuit Courts of Appeal have expressly rejected the possibility that circumstances beyond a person's control might render his conduct less than willful. *See, e.g., Harrington v. United States*, 504 F.2d 1306, 1316 (1st Cir. 1974); *Pacific National Insurance Co. v. United States*, 422 F.2d 26, 33 & n. 19 (9th Cir.), *cert. denied*, 398 U.S. 937 (1970); *Monday v. United States*, 421 F.2d 1210, 1216 (7th Cir.), *cert. denied*, 400 U.S. 821 (1970).

The Second Circuit Court of Appeals, while holding that reasonable cause can bar liability under section 6672, has defined reasonable cause in an entirely different manner than the Tenth Circuit. Under the Second Circuit's definition, a responsible person's "failure to cause the withholding taxes to be paid is not willful if he [or she] believed that the taxes were in fact being paid, so long as that belief was, in the circumstances, a reasonable one." *Winter v. United States*, 196 F.3d 339, 345 (2nd Cir. 1999) (internal quotation omitted).

The Petitioner contends that the Eleventh Circuit Court of Appeals, and the other circuits that have rejected the reasonable cause limitation on the definition of willfulness

are incorrect. The word "willfully," no matter the context, "still denotes a conscious motion of the will." *Finley*, 123 F.3d at 1347 (citing BLACK'S LAW DICTIONARY 1434 (5th ed. 1979)). The inquiry is thus "necessarily directed to the state of the responsible person's mind," and is properly an issue of "scienter"—"the quintessential jury issue." *Finley*, 123 F.3d at 1347 (quoting *Thibodeau*, 828 F.2d at 1505; and *Turpin v. United States*, 970 F. 2d 1344, 1350 (4th Cir. 1992)). Those courts who have continued to seize upon certain factual paradigms to define willfulness as a matter of law are "depriving the word 'willfully' of its operative effect." *Finley*, 123 F.3d at 1347.

The Petitioner further contends that had the Eleventh Circuit Court of Appeals seized the opportunity to limit the expansive definition of willfulness, the conduct of the Petitioner would have met any reasonable definition thereof, and would almost certainly have met the standard of reasonable cause pronounced by the *Finley* court. Upon Petitioner's learning of the delinquent taxes, he immediately confronted the company's controlling shareholder, Garner Umphrey, and then asked the company's bookkeeping department to begin making $30,000 weekly payments to the IRS even though he did not know the amount of past due payroll taxes. This was a "reasonable effort to protect the trust funds," the first element of the Tenth Circuit's reasonable cause exception to section 6672 liability. *See Finley*, 123 F.3d at 1348. At trial, the Petitioner also showed that the $30,000 payments were stopped on the command of Umphrey, the controlling shareholder. Thus, Petitioner's "efforts [were] frustrated by circumstances outside the [Petitioner's] control," meeting the second element of the Tenth Circuit's reasonable cause limitation. *Id.* Moreover, Petitioner made additional payments to the IRS once Lorac had filed for bankruptcy protection.

II. CERTIORARI IS WARRANTED BECAUSE THE ELEVENTH CIRCUIT COURT OF APPEALS HAS DECIDED AN IMPORTANT QUESTION OF FEDERAL LAW REGARDING THE PAYROLL TAX PENALTY THAT HAS NOT BEEN, BUT SHOULD BE, SETTLED BY THIS COURT.

The word "willfully" in a penal statute should require something more than carelessness. This Court has previously recognized the national importance of the Government's enforcement of a penal statute that required willful acts and granted certiorari to interpret the word "willful" to require specific knowledge of unlawfulness.

In *Ratzlaf v. United Sates*, 510 U.S. 135 (1994), this Court interpreted willfulness in a statute that penalized the structuring of deposits to avoid the reporting requirement for bank deposits of $10,000 or more. This Court rejected a watered down version of willfulness used by the court of appeals and championed by the Government, and held that when Congress structures a statute with a "willfulness" requirement, it does so intentionally, and if it intends to create a strict liability statute, it may do so by design. *Id.* at 146. This Court held that "to convict Ratzlaf of the crime with which he was charged . . ., the jury had to find he knew the structuring in which he was engaged was unlawful." *Id.* at 149.

Similarly, section 6672 was originally a criminal statute. *See Lyle*, *supra*, note 2. Even after its movement to the civil portion of the Code, it retains its penal nature.

By interpreting the term willfulness in section 6672 to exclude circumstances for which an employee has reasonable cause for failing to remit payroll taxes, this Court could again restore the plain meaning of the intent requirement in a penal statute. The Government should have to show that an employee acted with intent to violate his personal duty to pay

over payroll taxes. By requiring culpability, the statute would focus on those employees who steal or refuse to pay when their company has the resources to do so, but will not penalize an employee who makes a good faith effort to pay, but whose efforts are thwarted by circumstances beyond his control.

CONCLUSION

The interpretation of willfulness to mean what it says will have a broad nationwide impact. The Government's egregious imposition of the hammer of personal liability under section 6672 is not isolated to the Petitioner, but is often used on the employees of small businesses, many of whom cannot afford to litigate the assessment of the penalty. *See generally Lyle*, *supra*, note 2, *passim* (collecting cases).

For the foregoing reasons, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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